



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424

501.03-00

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

March 3, 2010

Release Number: 201025080

Release Date: 6/25/10

LEGEND

ORG = Organization name

XX = Date Address = Address

ORG

ADDRESS

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: June 1, 20XX

Dear

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective January 1, 20XX.

Our adverse determination was made for the following reasons:

A substantial part of your activities consists of providing down payment assistance to home buyers. To finance the assistance you rely on home sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. Your receipt of a payment from the home seller corresponds to the amount of the down payment assistance provided in substantially all of your down payment assistance transactions. The manner in which you operate demonstrates you are operated for a substantial nonexempt purpose. Accordingly, you are not operated exclusively for exempt purposes described in section 501(c)(3).

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling or writing to:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

Nanette M. Downing
Acting Director, EO Examinations

Internal Revenue Service

Department of the Treasury

1100 Commerce

Dallas, Tx 75242

Date: November 19, 2007

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 12/31/20XX

LEGEND

ORG = Organization name XX = Date Address = address City = city
State = state County = county President = president Bookkeeper =
bookkeeper CI-1 & Co-2 = 1st & 2nd COMPANIES

Issue:

Whether ORG (ORG) operated exclusively for exempt purposes within meaning of Internal Revenue Code section 501(c)(3)?

Facts:

ORG is a State not-for-profit corporation incorporated on February 20, 19XX. The organization amended its Articles of Incorporation on July 28, 20XX, to include a proper dissolution clause and other provisions. President is ORG's registered agent, President, and CEO. ORG's address has been changed from Address, City, State to Address, City, State.

On February 1, 20XX, ORG submitted an Application for Recognition of Tax-Exempt Status, Form 1023, as an organization described in Internal Revenue Code section 501(c)(3). Based on the information that ORG provided in its Form 1023 and on the assumption that ORG would operate in the manner represented in its application, the Internal Revenue Service (IRS) recognized ORG as a tax-exempt organization as described in section 501(c)(3) by letter dated October 27, 20XX.

ORG's exemption letter provided that ORG would operate under an advance ruling until December 31, 20XX. The letter further indicated that ORG could reasonably expect to be recognized as a publicly supported organization described in section 509(a)(2). On December 31, 20XX, ORG completed its advance ruling period. ORG failed to submit Form 8734 within the 90 day period. On May 19, 20XX, the Service issued Letter 1048 stating that ORG was being classified as a private foundation. On May 24, 20XX, ORG submitted Form 8734, support schedule for advance ruling period. The support schedule reported that ORG was not funded for 19XX and 20XX and that it received all funding from gifts, grants and contributions during 20XX, 20XX and 20XX.

On April 14, 20XX, ORG submitted an amended Form 8734 in which it reported that it was not funded during 19XX and 20XX and that it received all funding from exempt function income for 20XX, 20XX, 20XX, and 20XX. Based on further analysis of the exempt function income for the above listed periods, the Internal Revenue Service (IRS) concluded that ORG was being funded solely by the fees that it receives from participating in its down payment assistance program. On January 27, 20XX, the IRS issued Letter 1050 to ORG stating that ORG is recognized as a public charity described in section 509(a)(2).

Application for Recognition of Tax-Exempt Status:

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ORG reported the following proposed activities in its application:

- Providing tutorial for students, grades 1 – 12 and basic educational Computer based training for dropout students between the ages of 14 – 24 to prevent students from dropping out of school and to prepare them for GED and high school graduation.
- ORG will specialize in training conducive to Computer Technology such as: bookkeeping, basic account, typing, web training, graphic creation, advertising, basic camera skills and video editing.
- Participants must have an income below the Federal poverty level; must live in the County County area and be a legal citizen of the USA.
- Training activities will be conducted at ORG educational building and computer laboratory and if necessary, other collaborating sites in geographical areas of the community that have been targeted for services.
- Program activities will be advertised via public service announcements, local newspapers, public schools, churches and other community based organizations.
- The Sources of support would be from Donations from the general public.
- ORG will not have any fundraising activities but will solicit grants from Foundations, Federal Government and State Agencies.

Articles of Incorporation:

The Articles of Incorporation for ORG, dated February 20, 19XX, state the following:

“The Corporation is organized exclusively for charitable purposes, including for such purposes, the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the Code (or the corresponding provision of any future United States Internal Revenue Law).”

These specific purposes were stated in the Articles of Incorporation:

“To provide child care assistance, to provide educational support and direction to the community, To sponsor activities to raise funds for the Corporation, To engage in any business not prohibited by the Laws of the State of State, To publish a newsletter periodically to keep interested persons informed concerning the activities of the Corporation.”

The following “Restriction on Powers” was included: “No part of the net earnings of the corporation will inure to the benefit of, or be distributed to its members, directors, officers, or other private persons, except for the compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article (4) hereof.”

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The Articles of Incorporation for ORG also have a dissolution clause which requires that, upon dissolution, the remaining net assets will be distributed to another organization described in section 501(c)(3) or to a State or local Government.

Federal Returns:

ORG did not file Forms 990 for calendar years 20XX, 20XX, 20XX and 20XX. The President indicated that ORG did not have enough income to be required to file Forms 990. ORG did not file Forms 941, W-2, and 1099-MISC, since ORG had no paid employees. The examination for 20XX indicated, based on bank statements, that ORG was determining the amount of its income by netting and had enough gross receipts to be required to file Form 990 for 20XX. The agent made a verbal request by telephone to the President on January 10, 20XX, that he provide a breakdown of income and expenses (based on the bank statements) for the periods 20XX, 20XX and 20XX to determine whether Forms 990 should have been filed for these periods.

The President indicated that no income was received for 19XX and 20XX. In 20XX, 20XX, 20XX and 20XX, ORG's only reported activity consisted of operating its DPA program. The agent received information from the President on January 22, 20XX. Based on the documentation provided, ORG should have filed Forms 990 for 20XX and 20XX but had no requirement to file a Form 990 for 20XX.

ORG does not compensate individuals to conduct its activities, including its down payment assistance program; therefore, the income from the fees charged by ORG to the sellers participating in its down payment assistance program does not constitute unrelated business income. I.R.C. § 513(a)(1).

Operation of ORG's Down Payment Assistance Program:

ORG stated that it had no brochures, advertisements, other publicity, or a website with respect to its down payment assistance (DPA) program. According to ORG, its involvement in DPA is determined by the realtors.

Many of the participants in ORG's DPA program utilize Federal Housing Administration (FHA) financing for their home purchase. To qualify for a federally insured mortgage, a buyer must make a down payment in a specified minimum amount, generally equal to 3% of the purchase price. To qualify under applicable Department of Housing and Urban Development (HUD) rules, such a buyer may receive gifts to use for the down payment only from a relative, employer, labor union, charitable organization, close friend, governmental agency, or public entity. The seller cannot loan money to the buyer for the down payment.

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Once the buyer locates a home he/she wants to purchase, the buyer and seller enter into a contract. Each seller must sign a Participating Home Agreement as a part of the contract. This agreement obligates the seller, in consideration for participating in ORG's DPA program, to make a contribution to ORG in the amount of the down payment assistance plus a service fee on the day of closing. The agreement, required to be signed by each participating seller, includes the following statement:

The Seller agrees to make a contribution to ORG of 3% of the contract sales price of the participating Home Plus a fee of \$ the day of closing from the transfer of the Participating Home to the Buyer. Seller understands that the contribution will not be used to provide down payment assistance to the Buyer of the Participating Home and that the gift funds provided to the Buyer toward the purchase of the Seller's home are derived from pre-existing funds. Seller further understands that the Seller is only obligated to make the contribution if a home buyer utilizing ORG's DPA Program purchases the participating home. Seller acknowledges that in the event that the Buyer is unsuccessful in obtaining a loan or the loan does not close within two days after the gift funds are deposited to escrow or with the closing agent, Seller instructs and authorizes the escrows or closing agent to return the gift funds to ORG without recourse. Seller understands that the Seller is not obligated to make a contribution if the escrow/closing is terminated.

ORG does not provide down payment assistance to the buyer if the seller does not enter into the agreement. If the seller agrees to participate, the agent and buyer proceed to try to get the buyer approved for a loan through a mortgage company which will accept gift funds from a 501(c)(3) organization. ORG provides the lender with a Gift Fund Acknowledgement letter to advise the lender of the amount of the "gift funds" the buyer will receive. When the loan is approved, the Realtor informs ORG of the date of the closing and the amount ORG will provide at closing. The President then gets a Certified check which he hand delivers to the closing Attorney the day of the closing. The President attends the closings.

The money is never given to the buyer. The check is made payable to the closing attorney. Once the closing is completed, the closing attorney gives ORG a check for the DPA assistance fee. Based on a telephone conversation with the President on January 12, 20XX, the DPA fee runs between three (3%) and four (4%). The President stated that ORG has never received the transfer fee of \$.

If the sale is not completed, the seller provides no funds to ORG. In 20XX, 20XX, 20XX, and 20XX, ORG received 100 percent of its income from transactions where there was an agreement between a buyer and seller regarding a specific property owned by the seller. ORG does not provide "gift funds" to any buyer when the seller of the home does not agree to participate in the agreement.

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The records provided by ORG did not include data on the buyers' incomes and gave no indication that ORG screened such data. Rather, ORG's DPA program provided "gifts" to any homebuyers who qualified for a loan. The President was contacted by telephone on January 12, 20XX, regarding ORG's participation in the DPA program. The President stated that the realtor handles everything, including screening the applicant, checking to see if the applicant qualifies based on their income, etc. ORG has no contact with either the buyer or seller prior to closing.

On the HUD Settlement Statement for each closing, the "gift funds" plus the service fee charged by ORG is shown as "Gift Funds/Service Fee" on the seller's summary of transactions, while on the buyer's summary the DPA less ORG's fee is shown as "ORG Gift Funds".

In essence, these transactions result in a circular flow of the money. The sellers make payments to ORG. ORG provides the funds to the buyers (although, in practice, the funds go through the closing attorney and do not go directly to the buyers), who use the funds to make the down payment necessary to purchase the homes from the sellers.

In addition, ORG stated that it provides no services after closing and that no one has asked for any after-services. ORG further stated that no advice is given by ORG to sellers or participants of the DPA program. The only advice given to the buyers is provided by the selling agent and the closing attorney. ORG further stated it has no seminars for prospective home purchasers.

The President of ORG indicated by telephone on January 12, 20XX, that the realtors handled the complete transactions from start to finish. ORG had no contact with either the buyer or seller prior to the closing. ORG's DPA program provided gifts to any home buyer who the realtor determined qualified for a loan. ORG provided no counseling or seminars to prospective home purchasers. The President indicated that any counseling was provided by the realtor and closing attorney.

When asked why ORG did not notify the Internal Revenue Service of the change in activities as required by law, the President stated that he thought that it did not matter how money was brought into the organization as long as it was legal and that the money was spent appropriately.

No Additional Activities:

Although ORG's Form 1023 described such proposed activities as providing tutoring to public school students and computer training, the President of ORG advised that such activities never took place.

Financial Information:

Bookkeeper (the President's sister who is not an officer) maintains the books for ORG. The organization had one checking account with CO-1 through which all of the financial activity of

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the organization was conducted. Although both the Treasurer and President have signature authority for signing checks, the President signed all checks for 20XX. No personal expenses appear to have been paid from the checking account for 20XX. No one received a salary from ORG.

In 20XX, 20XX, 20XX, and 20XX, ORG's only source of revenue was from service fees charged with respect to the DPA program. The total revenue is the gross amount of the seller service fees. ORG then pays out the down payment funds to the buyers. ORG makes no solicitations for charitable contributions.

Regarding compensation, ORG did not pay its President, President, a salary. The original application lists President as the President and indicates that he is to receive no compensation. President has performed the duties of the President and has considered himself the President of ORG from its inception. ORG reported that it paid no salary or wages with respect to any of its activities, including its down payment assistance program.

Wages

ORG stated that it has no paid employees. Therefore, Forms 940, 941 and 945 were not filed.

Internal Control

ORG has no internal controls. President, its founder and president, controls the bank account. The Board of Directors meets periodically to discuss business. ORG provided corporate minutes for December 3, 20XX, July 7, 20XX, March 31, 20XX, December 29, 20XX, March 30, 20XX, and February 29, 20XX. The minutes reflected that all financial reports given by the President were related to the DPA program. The minutes do not reflect that any other activities were conducted by ORG. The minutes do not reflect which Board members were present for the meetings. No Board approvals of any discussions held during the meetings were documented in the minutes.

Law and Analysis

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings of such corporations inures to the benefit of any private shareholder or individual. See § 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In Better Business Bureau of Washington, D.C. v. United

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States, 326 U.S. 279, 283 (1945), the Supreme Court held that the “presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes.”

Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Treasury Regulation section 1.501(c)(3)-1(d)(2) defines the term “charitable” for section 501(c)(3) purposes as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term “charitable” also includes the advancement of education.

Treasury Regulation section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term “educational” for section 501(c)(3) purposes relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Treasury Regulation section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of section 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization’s primary purpose does not consist of carrying on an unrelated trade or business.

In Easter House v. United States, 12 Cl. Ct. 476, 486 (1987), aff’d, 846 F. 2d 78 (Fed. Cir. 1988), the U.S. Court of Federal Claims considered whether an organization that provided prenatal care and other health-related services to pregnant women, including delivery room assistance, and placed children with adoptive parents qualified for exemption under section 501(c)(3). The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization’s argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization’s operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization’s sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial income. In addition, although the organization provided health care to indigent pregnant women, it only did so when a family willing to adopt a woman’s child sponsored the care financially.

Accordingly, the court found that the “business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff’s adoption service is its primary goal” and held that

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the organization was not operated exclusively for purposes described in section 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals but could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in section 501(c)(3) because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did "comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner." American Campaign Academy, 92 T.C. at 1077.

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other non-profit organizations and shops operated for exclusively charitable purposes within the meaning of section 501(c)(3). The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence collected by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from communities of craftsmen. The organization did not market the kind of products produced by studio craftsmen, nor did it market the handicrafts of artisans who were not disadvantaged. The court concluded that the overall purpose of the organization's activity was to benefit disadvantaged communities. The organization's commercial activity was not an end in itself but the means through which the organization pursued its charitable goals. The method the organization used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes described in section 501(c)(3).

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D. D.C., 2003), the court relied on the commerciality doctrine in applying the operational test. Because of the commercial manner in which the organization conducted its activities, the court found that it was operated for a nonexempt commercial purpose, rather than for a tax-exempt purpose. As the court stated:

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Among the major factors courts have considered in assessing commerciality are competition with for-profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations.

See also, Living Faith Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) (holding that a religious organization which ran restaurants and health food stores in furtherance of its health ministry did not qualify for tax-exempt status because it was operated for substantial commercial purposes and not for exclusively exempt purposes).

Revenue Ruling 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is a "charitable" activity because it relieves the poor and distressed or underprivileged. The organization described in Revenue Ruling 67-138 carried on several activities directed to assisting low-income families obtain improved housing, including (1) conducting a training course on various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Revenue Ruling 70-585, 1970-2 C.B. 115, discussed four situations in which organizations provided housing and whether the organization described in each situation qualified as a charitable organization described in section 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families who were eligible for loans under a Federal housing program but did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that, by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions, the revenue ruling held that the organization was engaged in charitable activities within the meaning of section 501(c)(3).

Situation 3 described an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. The median income level in the area was

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lower than in other sections of the city and the housing in the area generally was old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area, sponsored a renewal project, and involved residents in the area renewal plan. The organization also purchased an apartment building that it rehabilitated and rented at cost to low and moderate income families with a preference given to residents of the area. The revenue ruling held that the organization was described in section 501(c)(3) because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The revenue ruling held that the organization failed to qualify for exemption under section 501(c)(3) because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of section 501(c)(3) and the regulations.

Revenue Ruling 2006-27, 2006-21 C.B. 915, in part, discusses whether organizations that provide DPA operate exclusively for charitable purposes. Revenue Ruling 2006-27 held that an organization described in Situation 2 does not qualify as an organization described in section 501(c)(3) because: (1) it relies for its revenue on sellers and other real-estate related businesses that stand to benefit from the transactions the organization facilitates; (2) the organization's grant making staff knows the identity of the home seller and the identities of other interested parties and is able to take into account whether the home seller or another interested party is willing to make a payment to the organization in making its decisions; (3) the organization's receipt of a payment from the home seller corresponds to the amount of the down payment assistance in substantially all of the transactions; and (4) the organization's reliance on these payments for most of its funding indicates that the benefit to the home seller is a critical aspect of the organization's operations. In this respect, the organization is like the organization considered in Easter House, which received all of its support from fees charged to adoptive parents, such that the business purpose of the adoption service became its primary goal and overshadowed any educational or charitable purpose.

Like the organization considered in American Campaign Academy, Eastland is structured and operated to assist private parties who are affiliated with its founders. Because Eastland is not operated exclusively for exempt purposes, the organization does not qualify for exemption from federal income tax as an organization described in section 501(c)(3).

Benefiting Private Interests:

Even if an organization's activities serve a charitable class or are otherwise charitable within the meaning of section 501(c)(3), it must demonstrate that its activities serve a public rather than a private interest within the meaning of Treasury Regulation section 1.501(c)(3)-1(d)(1).

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Revenue Ruling 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low income families did not qualify for exemption under section 501(c)(3) because it gave preference to employees of a business operated by the individual who also controlled the organization. The ruling reasoned that, although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

In *CO-2 Fund Raisers v. Commissioner*, T.C. Memo 1997-424 (1997), aff'd 166 F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in a substantial private benefit to its founders. The founders of the organization were the sole owners of CO-2, a lounge at which alcoholic beverages were served. The founders served as officers of the organization and, at times, also controlled the organization's board. The Tax Court found, and the Second Circuit agreed, that the founders exercised substantial influence over the affairs of the organization. The organization's business consisted of selling "Lucky 7" or similar instant win lottery tickets to patrons of CO-2. The organization derived most of its funds from its lottery ticket sales.

The organization solicited no public donations. The lottery tickets were sold during regular business hours by the owners of the lounge and their employees. From the proceeds of the sales of the lottery tickets, the organization made grants to a variety of charitable organizations. Tax Court upheld the Commissioner's denial of exemption to the organization on the ground that the organization's operation resulted in more than incidental private benefit. The Tax Court held, and the Second Circuit affirmed, that a substantial purpose of CO-2 activities was to benefit CO-2 and its owners by attracting new patrons, by way of lottery ticket sales, to CO-2, and by discouraging existing customers from abandoning CO-2 in favor of other lounges where such tickets were not available. Thus, the organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3).

Effective date of revocation:

An organization may ordinarily rely on a favorable determination letter received from the Internal Revenue Service. Treas. Reg. §1.501(a)-1(a)(2); Rev. Proc. 20XX-4, 20XX-1 C.B. 123 §14.01 (cross-referencing §13.01 et seq.). An organization may not rely on a favorable determination letter, however, if the organization omitted or misstated a material fact in its application or in supporting documents.

In addition, an organization may not rely on a favorable determination if there is a material change, inconsistent with exemption, in the organization's character, purposes, or methods of operation after the determination letter is issued. Treas. Reg. § 601.201(n)(3)(ii); Rev. Proc. 90-27, §13.02, 1990-1 C.B. 514.

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The Commissioner may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2). Revocation of a determination letter may be retroactive if the organization omitted or misstated a material fact or operated in a manner materially different from that originally represented. Treas. Reg. § 601.201(n)(6)(i), § 14.01; Rev. Proc. 20XX-4, § 14.01.

Analysis:

ORG is not described in section 501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in section 501(c)(3) and (2) provides substantial private benefit to persons who do not belong to a charitable class.

Charitable purposes include relief of the poor and distressed. See Treas. Reg. § 1.501(c)(3)-1(d)(2). ORG's down payment assistance program does not operate in a manner that primarily addresses the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Rev. Rul. 70-585, Situation 1. The down payment assistance program did not serve exclusively low-income persons. ORG did not screen applicants for down payment assistance based on income. ORG's records do not include data on the buyers' incomes. Instead, the program is open to anyone who, without income limitations, otherwise qualified for the loan. ORG has no contact with the buyer or seller prior to closing.

ORG's DPA program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Rev. Rul. 70-585, Situation 4. Down payment assistance is available for the purchaser of any property who is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes in a broadly defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of section 501(c)(3).

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if ORG's DPA program was directed to exclusively low-income individuals or disadvantaged communities, ORG's total reliance on home sellers for financing its DPA activities demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), ORG is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in ORG's DPA program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time the home is on the market. They also benefit by being able to sell their home at the home's full listed price or by being able to reduce the amount of the negotiated discount on their homes. Buyers who

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participate in ORG's DPA program benefit by being able to purchase a home without having to commit more of their own funds.

Real estate professionals who participate in ORG's DPA program, from real estate brokers to escrow companies, benefit from increased sales volume and the attendant increase in their compensation. It is evident from the foregoing that ORG's DPA program provides ample private benefit to the various parties in each home sale.

The manner in which ORG operated its DPA program shows that the private benefit to the various participants in ORG's activities was the intended outcome of ORG's operations rather than a mere incident of such operations.

ORG's down payment assistance procedures are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, ORG relies exclusively on sellers and other real-estate related businesses that stand to benefit from the transactions it facilitates. ORG neither solicits nor receives funds from other sources. No DPA assistance transactions take place unless ORG is assured that the amount of the down payment plus the fee is or will be paid by the seller upon closing. ORG's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to the home seller (and others involved in the transaction) is not a mere accident but rather an intended outcome of ORG's operations. In this respect, ORG is like the organization considered in Easter House which provided health care to indigent pregnant women, but only when a family willing to adopt a woman's child sponsored the care financially.

Based on the foregoing, ORG has not operated exclusively for exempt purposes, and, accordingly, is not entitled to exemption under section 501(c)(3). The government proposes revoking ORG's exemption beginning January 1, 20XX, because the organization operated in a manner materially different from that represented in its application for exemption.

In its application for exemption, ORG's stated purposes were to provide child care assistance, to provide educational support and direction to the community, to publish a newsletter periodically to keep interested persons informed concerning the activities of the organization; to sponsor activities to raise funds for the organization and to engage in any business not prohibited by the laws of the State of State.

ORG did not indicate in its application that it would provide down payment assistance, which has been its only activity. No records were provided by ORG on the buyers' incomes. Since ORG's activities are materially different from the activities represented in its application for exemption, revocation of ORG's exempt status effective January 1, 20XX (the first tax year that ORG was involved with the DPA Program and received income from the activity) is

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appropriate. Treas. Reg. § 601.201(n)(6)(i); Rev. Proc. 20XX-4, 20XX-1C.B. 123 §14.01.

Conclusion:

In order to be described in section 501(c)(3), an organization must be both organized and operated to achieve a purpose that is described therein. ORG is operating a seller-funded down payment assistance program in which it generates 100 percent of its income. It is not operated for an exempt purpose described in section 501(c)(3). ORG did not notify the Service of a change in its operations from that represented in its application as required by the Treasury Regulation section 1.6033-2(i)(1).

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that, in 20XX, 20XX, 20XX and 20XX, ORG operated in a manner materially different from that represented in its Form 1023 application, revocation effective January 1, 20XX, the first tax year that ORG participated in the down payment assistance program and received down payment assistance fees, is proposed.

Form 1120 is due for the tax year beginning January 1, 20XX, and the tax years thereafter.

Taxpayer's Position:

The government is unaware of ORG's position with respect to the issues, facts, and applicable law discussed in this report. The President of ORG has stated that he and the Board had talked about terminating ORG due to the declining DPA program income. ORG will be allowed 30 days to review this report and respond with a rebuttal.